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IN THE

Supreme Court of the United States

October Term, 1947
No. 667

DIVISION OF LABOR LAW ENFORCEMENT, STATE OF CALIFORNIA, STATUTORY ASSIGNEE, ETC.,

Appellant,

vs.

GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Appellees.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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Appellant,

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GEORGE T. GOGGIN, Trustee in Bankruptcy of the Estate of Kessco Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Ninth Collection District of California,

Appellees.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, George T. Goggin (hereinafter referred to as trustee), as trustee in bankruptcy of the estate of Kessco Engineering Corporation, a corporation, prays that a writ of certiorari issue to review the final judgment of the United States Circuit Court of Appeals for the Ninth Circuit, said judgment determining that although the Collector of Internal Revenue, on behalf of the United States of America, had possession of personal property assets of the bankrupt prior to and at the time of the commencement of the within bankruptcy proceedings, nevertheless; the Collector lost the priority accorded to

him by Section 64(a) and Section 67(c) of the Bankruptcy Act, because he permitted the receiver in bankruptcy to take over said assets and to administer and sell the same; that in connection therewith the labor claims were entitled to priority of payment even though an agreement existed between the Collector and the receiver in bankruptcy that except for administrative expenses the lien of the Collector arising through possession would be transferred to the proceeds from the sale of the personal property. In effect the judgment of the Court below erroneously held that the Collector of Internal Revenue must maintain his actual possession of the personal property upon which he has made a seizure both before and after the commencement of the bankruptcy proceedings in order to retain his prior statutory lien pursuant to the provisions of Section 64 and Section 67(c) of the Bankruptcy Act.

Opinion Below.

The opinion of the Circuit Court of Appeal is not yet reported, but for the convenience of this Court the aforesaid opinion is set forth verbatim in the appendix. The judgment of the District Court merely affirmed the referee in bankruptcy, without an opinion.

Jurisdiction.

The judgment of the Circuit Court of Appeals for the Ninth Circuit was filed on December 9, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, Chapter 229, Section 1, 43 Stat. 938, 28 U. S. C. A., Sec. 437(a); and under Section 24(c) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 553, as amended by the Act of June 22, 1938, c. 575, Sec. 1, 52 Stat. 854; 11 U. S. C. A. Supp., Sec. 47(c).

Questions Presented.

1. If the Collector of Internal Revenue, on behalf of the United States of America, has recorded tax lien claims, and pursuant thereto has physically seized personal property of the bankrupt, prior to bankruptcy, does this actual possession give him a priority over labor claimants under the provisions of Section 67(c) of the Bankruptcy Act?

2. Assuming that the Collector was in actual possession of the personal property when bankruptcy commenced, does he lose his priority over labor claims by voluntarily surrendering his possession to the receiver in bankruptcy pursuant to an agreement that subject only to payment of expenses of administration the proceeds from the sale of the personal property would be first subject to the payment of the lien of the Collector?

Statutes Involved.

1. Section 64, Subdivision (a) of the Bankruptcy Act, as amended (United States Code, Title 11, Chap. 7, Sec. 104), reading as follows:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of

administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; PROVIDED, that no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; AND PROVIDED FURTHER, that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who, by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law; PROVIDED, HOWEVER, that such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy."

2. Section 67 on Liens and Fraudulent Transfers (United States Code, Title 11, Chap. 7, Sec. 107), particularly subdivisions (b) and (c) as follows:

"(b) The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

"(c) Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter X, XI, XII, or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act."

Statement.

The facts in the case at bar are undisputed.

The appellant below, respondent herein, accepted as the statement of facts the recitation contained in the certificate of the referee on petition for review in connection with the appeal by the said appellant to the District Court, and from this certificate we quote as follows [Record before Appellate Court, pp. 26-28]:

> "This proceeding began on March 26, 1946. On that date all of the assets, later liquidated by the trustee, were in the physical possession of the Collector of Internal Revenue. The Collector had previously made a seizure of the said assets pursuant to certain tax claims against the bankrupt, which tax claims are specifically described in Exhibit 'A' of your Referee's findings of fact, conclusions of law and order, a true copy of which is going up with this certificate. In addition to having made a physical seizure of the said assets, the Collector of Internal Revenue, prior to the commencement of this bankruptcy proceeding, had filed notices of lien with respect to various taxes, including the tax claims set forth in the said Exhibit 'A'. Pursuant to his legal rights and remedies, by virtue of the said seizure, the Collector of Internal Revenue had conducted a sale of the said assets and had received bids thereon, but the said sale was not completed because the price obtainable was unsatisfactory to the Collector. A second sale by the Collector was instituted but was abandoned when the said assets were relinquished to the receiver in this matter, as hereinafter set forth.
>
> On March 26, 1946, the day this proceeding began, George T. Goggin, now trustee, was appointed receiver in this matter. He qualified as such receiver on March 28, 1946. Upon his appointment and quali-

fication, the said receiver contacted the office of the Collector of Internal Revenue and conversations were had between the receiver and counsel in the Los Angeles office of the Collector relating to the turning over of the said assets by the Collector to the receiver. Thereafter, the following telegram was received by the Los Angeles office of the Collector of Internal Revenue from J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue:

> 'Reference to telephone conversation today with Mr. Webb relative to Kessco Engineering Corporation, bankrupt, no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale.
>
> J. P. WENCHEL
> Chief Counsel.'

The contents of the said telegram were imparted by telephone to the office of the said receiver. No formal acceptance or acknowledgment thereof was made by the receiver. No notice of the telegram or of its contents was given to any of the creditors or other parties in interest in this matter and no notice thereof was given at the time of the trustee's sale of the aforesaid assets. After the said telegram had been imparted to the office of the said receiver, as aforesaid, the said receiver, with full knowledge of the said telegram and of its contents and without any objection thereto, took over the possession of the said assets from the Collector of Internal Revenue. Later the said receiver, in his capacity as trustee, caused the said assets to be sold at public auction, pursuant to the order of this Court."

On October 17, 1946, the petitioner herein filed a petition for order to show cause re: Tax & Labor Claimants, dated October 4, 1946, and, pursuant to this petition, an order to show cause was duly issued by the Referee in Bankruptcy on October 18, 1946, directing the various tax and labor claimants to show cause why the said referee should not determine the priority and method of payment of the expenses of administration, tax claimants, and prior labor claimants. Hearing was duly had thereon upon the 30th day of October, 1946; thereafter, the Referee duly signed findings of fact, conclusions of law and an order, finding as follows:

1. That from the monies in the possession of George T. Goggin, as trustee, there shall first be paid the expenses of administration.

2. That after the payment of the expenses of administration, the balance of the funds then in the hands of the trustee should be paid to the Collector of Internal Revenue in partial payment of the tax claim for which he had filed and recorded a lien and had seized actual possession of personal property involved, prior to the commencement of the bankruptcy proceeding; the amount of said lien and seizure claims being more than the total of the funds in the hands of the trustee arising from the sale of the physical assets.

The respondent herein, the Division of Labor Law Enforcement for the State of California, filed a petition for review from the order of the referee and the matter was duly heard before the District Judge below, and the Honorable Campbell E. Beaumont, as said District Judge, duly made and entered an order, on May 21, 1947, confirming the order of the referee above referred to entered on De-

cember 12, 1946, and adopting the findings of fact and conclusions of law of the referee.

From the order of the District Judge the Division of Labor Law Enforcement for the State of California duly filed a notice of appeal and the matter was presented to the United States Circuit Court of Appeals for the Ninth Circuit and finally determined on December 9, 1947, by an opinion filed on that date. This opinion reversed the order of the referee and the District Judge and directed the referee to allow the labor claims represented by the Division of Labor Law Enforcement for the State of California as prior claims to be paid before paying any monies to the Collector of Internal Revenue on behalf of the United States of America, and petitioner now seeks review by certiorari.

Reasons for Granting the Writ.

1. This cause involves questions of far-reaching importance in the practical administration of bankruptcy problems, throughout the nation, necessitating an authoritative determination by this Court; the effect of the erroneous decision by the Ninth Circuit would be to compel the Collector of Internal Revenue to refuse to surrender possession of any physical property once he had seized the same prior to the commencement of bankruptcy proceedings and since bankruptcy courts and supervised sales have proven to be more advantageous to creditors than sales through the Collector of Internal Revenue, the result will be detrimental to the possibility of labor and unsecured creditor claimants recovering a fair dividend in any such case.

2. The decision of the Circuit Court of Appeal conflicts with a fundamental bankruptcy rule enunciated in many cases by this Court that the rights of all creditors, and their priorities, are determined as of the time that the bankruptcy proceedings are commenced.

Myers v. Matley (1943), 318 U. S. 622, 626;

U. S. v. Marxen (1939), 307 U. S. 200, 207-8;

White v. Stump (1924), 266 U. S. 310, 313;

Bailey v. Baker Ice Machine Co. (1915), 239 U. S. 268, 275;

Everett v. Judson (1913), 228 U. S. 474, 479;

Acme Harvester Co. v. Beekman Lumber Co. (1911), 222 U. S. 300, 307.

3. The decision of the Circuit Court of Appeals conflicts with the Bankruptcy Act, which provides that the statutory liens of the Collector of Internal Revenue, on behalf of the United States of America, on personal property accompanied by possession of said property is completely unaffected by Section 67(c) of the Bankruptcy Act and are prior in time of payment to wage claims.

4. The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court logically holding that receivers and trustees in bankruptcy may take over the physical possession of personal property held by a person under a claim of lien, and may sell such personal property, pursuant to the order of the referee, free of the lien claim; that such lien claim may then be transferred to the proceeds from the sale without disturbing the right of the claimant as it existed at the time that the bankruptcy proceeding commenced.

Van Huffel v. Harkelrode (1931), 284 U. S. 225.

5. The decision of the Circuit Court of Appeals for the Ninth Circuit is directly in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit, in petition of *International Harvester Co. of America* (C. C. A. 6th 1925), 9 F. (2d) 299, wherein the court finds that in the absence of any circumstances indicative of an express waiver of a lien claim, no waiver of a right of lien should be implied from the mere surrender of possession by a claimant to a receiver. The "measure stick" set up by the Sixth Circuit is entirely equitable, logical and in accordance with good business sense.

Conclusion.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted to review the judgment of the Circuit Court of Appeals for the Ninth Circuit.

Dated: March 1, 1948.

GEORGE T. GOGGIN, AS TRUSTEE,
Petitioner,

By MARTIN GENDEL,
Counsel for Petitioner.

GENDEL & CHICHESTER,
Of Counsel.

IN THE

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vs.

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Appellee.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

May It Please the Court:

Opinions Below.

The opinion of the Circuit Court of Appeals is not yet reported, but it set forth verbatim in the appendix attached to the within petition and brief. The opinion of the District Court merely adopted and confirmed the findings of fact, conclusions of law and order of the referee.

Jurisdiction.

The grounds upon which the jurisdiction of this court is invoked are stated in the petition at page 2.

Statement of the Case.

The facts appear in the petition at pages 6 to 9, and in the interest of brevity are not repeated herein.

Specifications of Error.

THE CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT ERRED:

1. In failing to recognize that the Collector of Internal Revenue, on behalf of the United States of America, by recording statutory tax liens and pursuant thereto having actual possession of personal property through seizure, at the time that the bankruptcy proceedings commenced, was then entitled to a priority over any labor claims; that this priority became fixed and frozen as of the commencement of the bankruptcy proceeding; that the subsequent surrender, by consent of the Collector of Internal Revenue, of custody of the personal property to the receiver in bankruptcy on condition that only the expenses of administration should be deducted from the proceeds of the sale of the personal property until the tax lien claims were paid in full, did not constitute a loss of the priority theretofore held by the Collector, and the provisions of Section 67(c) of the Bankruptcy Act could not be invoked by labor claimants in order to obtain any priority over the Collector as to the proceeds from the sale of the assets originally seized by him.

Summary of Argument.

1. The Collector of Internal Revenue, on behalf of the United States of America, having recorded statutory tax lien claims and pursuant thereto having physically seized personal property of the bankrupt prior to bankruptcy, thereby obtained actual possession of the personal property which entitled the Collector to a priority over labor claimants pursuant to the Bankruptcy Act and particularly Section 64(a) and Section 67(c) thereof.

2. The Circuit Court of Appeals failed to recognize a cardinal principle of Bankruptcy Law providing that the time when the bankruptcy petition is filed is the date of cleavage governing the rights of creditors to priority under Section 64(a) and Section 67(c) of the Bankruptcy Act.

3. Since the Collector was in actual possession of the personal property when bankruptcy commenced, he did not lose his priority over labor claims by voluntarily surrendering custody to the receiver in bankruptcy, because this surrender was pursuant to an agreement that subject only to payment of expense of administration, the proceeds from the sale of the personal property would be first subject to payment of the lien of the Collector.

4. The authorities cited by the respondent herein, *as appellant* before the Circuit Court of Appeals, do not support the opinion of the Circuit Court of Appeals and the one case cited by the Circuit Court of Appeals does not support its conclusion.

ARGUMENT.

1. The Collector of Internal Revenue, on Behalf of the United States of America, Having Recorded Statutory Tax Lien Claims and Pursuant Thereto Having Physically Seized Personal Property of the Bankrupt Prior to Bankruptcy, Thereby Obtained Actual Possession of the Personal Property Which Entitled the Collector to a Priority Over Labor Claimants Pursuant to the Bankruptcy Act and Paricularly Section 64(a) and Section 67(c) Thereof.

(a) Subdivision "c" of Section 67 of the Bankruptcy Act, as amended in 1938, expressly provides that labor claims as set forth in clause 2 of subdivision "a" of Section 64 of the Bankruptcy Act shall be subordinated to statutory liens for taxes owing to the United States providing that such liens on personal property are accompanied by possession.

(b) In Volume 4 of Colliers on Bankruptcy (14th Ed. 1942), we find the following undisputed statements of law:

Page 164:

> ". . . 3. Statutory liens . . . on personal property accompanied by possession of such property are completely unaffected by Section 67(c)."

Page 236 of the same volume:

> ". . . On the other hand the principle of subordination introduced by §67(c) does not apply in the case of the following liens: . . . (c) All statutory liens . . . on personal property accompanied by possession of such property."

and see,

In re Pennsylvania Central Brewing Co. (C. C. A. 3, 1940), 114 F. (2d) 1010, certiorari denied, 312 U. S. 685.

2. The Circuit Court of Appeals Failed to Recognize a Cardinal Principle of Bankruptcy Law Providing That the Time When the Bankruptcy Petition Is Filed Is the Date of Cleavage Governing the Rights of Creditors to Priority Under Section 64(a) and Section 67(c) Thereof.

(a) ". . . the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. . . . The transfer of the assets to someone for application to 'the debts of the insolvent, as the rights and priorities may be made to appear', takes place as of that time."

Quoted from

United States v. Marxen (1939), 307 U. S. 200, at pp. 207-208;

Myers v. Matley (1943), 318 U. S. 622, 626;

White v. Stump (1924), 266 U. S. 310, 313;

Bailey v. Baker Ice Machine Co. (1915), 239 U. S. 268, 275;

Everett v. Judson (1913), 228 U. S. 474, 479;

Acme Harvester Co. v. Beekman Lumber Co., (1911), 222 U. S. 300, 307.

(b) This general rule of law is reiterated in Collier's work on bankruptcy in many subdivisions thereof, particularly as follows:

In volume 4 at page 228 we find:

"The general rule in bankruptcy is that the filing of the petition freezes the rights of all parties interested in the bankrupt estate. . . ."

In volume 3 at page 2059, we find the same language paraphrased as follows:

> ". . . With regard to those claims accruing against the bankrupt prior to bankruptcy, the time when the petition is filed is the date of cleavage—that is, the date on which the right to priority under §64 must be determined. . . ."

3. Since the Collector Was in Actual Possession of the Personal Property When Bankruptcy Commenced, He Did Not Lose His Priority Over Labor Claims by Voluntarily Surrendering Custody to the Receiver in Bankruptcy, Because This Surrender Was Pursuant to an Agreement That Subject Only to Payment of Expense of Administration, the Proceeds From the Sale of the Personal Property Would Be First Subject to Payment of the Lien of the Collector.

(a) Personal property in the possession of a receiver and trustee in bankruptcy may be sold free from liens and encumbrances, and the liens will then be transferred to the proceeds. In the language of Volume 6, Remington, Bankruptcy Law (4th Ed. 1937), page 71, we contend as follows:

> ". . . And the right to sell property in the Bankruptcy Court clear and free from all incumbrances, and to transfer the lien to the proceeds, is now beyond dispute."[1]

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[1] 6 Remington, Bankrupty Law (4th Ed. 1937), p. 71:

"§2577. Selling Free From Liens and Transferring Liens to Proceeds.—The property may be sold free from liens and incumbrances, and the liens be transferred to the proceeds.

"No form was prescribed for this purpose by the Supreme Court, and no special authorization of sales free from liens is to be found

and again in Remington, Bankruptcy Law (4th Ed. 1937), in Volume 6, page 77, we find a restatement of the law heretofore quoted, in the following language:

> "§2578. Lienholder's Consent to Sale Free of Liens.—And it does not require the lienholder's consent, even where the referee orders the sale.
>
> "It is clear that, by agreement, property also may be sold clear and free and the liens transferred to the fund; and the agreement may be implied."

and, at page 78 of Volume 6, Remington cites 18 cases in support of the following statement of the law:

> "§2579. Selling Clear and Free before Validity or Priority of Liens Determined.—A sale free and clear from liens may be ordered before the validity

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in the statute itself; but, so far as statutory authorization is concerned, nothing is found in the statute specifically authorizing sales subject to liens, nor at private sales, nor of perishable property, and yet those methods of sale are deemed proper in bankruptcy. And it would be a serious defect were it not permissible to sell property in bankruptcy free from liens, because such is ordinarily the best method of selling property. To sell property free and clear from all liens, and to have all controversies relative to the validity and extent of liens thereon transferred to the fund, is likely to lead to better prices. Otherwise the purchaser would have to buy all the controversies along with the purchase of the property itself. And the right to sell property in the bankruptcy court clear and free from all incumbrances, and to transfer the liens to the proceeds, is now beyond dispute."

P. 75: "And it may be sold free, even from the lien of taxes."

P. 76: ". . . The provisions of the Bankruptcy Act that valid liens shall not be affected by bankruptcy proceedings has reference only to the validity of the contract, and not to the remedy nor forum for enforcing the lienholder's rights, which may be changed without impairing the contractual obligation, providing an equally adequate and efficient remedy is substituted."

". . . And the transferring of the liens to the proceeds of the sale is an incidental power of the Court."

and priority of the liens have been determined, the controversies being transferred to the funds."

And see:

Van Huffel v. Harkelrode (1931), 284 U. S. 225;

Coulter v. Blieden (C. C. A. 8th 1939), 104 F. (2d) 29, certiorari denied 308 U. S. 583.

(b) The petitioner herein, as receiver, accepted surrender of custody of the personal property in question under the express terms specified by the Collector to the effect that only expenses of administration would be allowed out of the proceeds from the sale of the assets, and that otherwise the lien would prevail until the taxes in question were paid in full; the Circuit Court of Appeals erred in failing to recognize that the tacit acceptance of the conditions imposed by the Collector maintained, in legal effect, the actual possession of the Collector which was his at the time that the bankruptcy proceedings commenced.[2]

(c) The conduct of the Collector of Internal Revenue, on behalf of the United States of America, and of your petitioner, as receiver, eliminates any possible contention that the Collector intended to waive his priority rights obtained by having made a physical seizure prior to bankruptcy.

(1) See subdivision "b" *supra* as to the terms specified by the Collector.

(2) Not only the law, but good logic, fair dealing, and practical business reasons require that the Bankruptcy Court should be permitted to sell the assets

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[2]See pages 6 to 9 of the Petition for Writ of Certiorari.

involved in a dispute and to transfer the dispute to the proceeds from the sale, without changing the rights of the parties, particularly where there are no grounds from which a waiver can be implied. We again respectfully call the attention of this court to the case of *International Harvester Co. of America* (C. C. A. 6, 1925), 9 F. (2d) 299, particularly at page 300, wherein the Court states the rule of law as follows:

> ". . . In the absence of any circumstances indicative of a waiver of the lien claim, such a waiver of a right should not be implied in fact from the mere surrender of possession to a receiver. . . . ."[3]

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[3]With apologies to this Honorable Court for quoting at length from the *International Harvester Company* case, we do feel that the language of the case is important to the proper presentation of our petition, and we quote therefrom at page 300:

> "It is, however, contended that petitioner is entitled to a lien because, pursuant to the mortgage, it had taken and was in possession of the chattels at the time of the adjudication in this voluntary bankruptcy proceeding. The referee, however, found that the petitioner had waived the possession so taken; that the received in bankruptcy had then acquired possession and had sold the goods as the bankrupt's property.
>
> Clearly there was a waiver of actual possession. The receiver did not take possession forcibly or without consent; but this possession, acquired after bankruptcy, does not necessarily involved a waiver of any right which by actual seizure petitioner may have acquired and may have had at the time of the filing of the petition in bankruptcy to retain the possession. Whether or not that right to possession and the lien, if any, thereby acquired, were waived, depends upon the agreement under which actual possession was surrendered and a sale by the receiver permitted. It is quite common expressly to agree that the bankruptcy court may determine the validity of a lien, and that such lien shall attach to the proceeds. One in possession may, however, expressly waive any claim of lien

The Circuit Court of Appeals for the Ninth Circuit has ruled directly contrary to the salutary rule of law as laid down by the Sixth Circuit, *supra*. We respectfully contend that this situation alone should justify the consideration and granting of the within petition for certiorari and the enunciation by this Court of a binding rule of law which will eliminate any confusion between Circuits.

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and be content to rank as a general creditor. The parties may fail to express their understanding in words. The court must then find it from the circumstances. In the absence of any circumstances indicative of a waiver of the lien claim, such a waiver of a right should not be implied in fact from the mere surrender of possession to a receiver. The desire to avoid controversy with the court's representative, the general willingness, especially of laymen, to submit to the bankruptcy court the determination of questions which, without such submission, might be, though laymen may not know them to be, beyond its compulsory jurisdiction, suffices to explain a transfer of possession without waiver of lien; indeed, in the belief that the claim to a lien would necessarily be adjudicated in the bankruptcy proceedings. The claim for priority, as filed, states that possession had been taken by petition and a sale advertised, but that this sale had been restrained by the bankruptcy court. In the objections filed by the trustee, no waiver, either of possession or of the right of possession, is alleged. In view of the informal nature of pleadings in such causes, this suffices, in our judgment, to compel a determination of petitioner's right to a lien because of its possession, and notwithstanding the subsequent surrender of actual possession. The trustee should be given opportunity to amend his objections, so as clearly to present the essential issues, especially as his counsel may have been led to believe by the colloquy at the end of the hearing, set forth in the footnote, that petitioner relied solely upon the filing of the mortgage.

Therefore, notwithstanding our concurrence in the construction of the statute, the petition to revise is granted, and the cause remanded, to permit the parties to amend the pleadings, and thereupon to determine whether or not, in the circumstances, petitioner obtained a valid lien by virtue of its possession prior to and at the time of filing the petition in bankruptcy (See *Peter Schuttler Co. v. Gunther*, 222 Mich. 430, 192 N. W. 661, 49 Am. Bankr. Rep. 678), and, if so, whether or not it waived this lien by reason of the surrender of the actual possession to the receiver."

4. The Authorities Cited by the Respondent Herein, as Appellant Before the Circuit Court of Appeals, Do Not Support the Opinion of the Circuit Court of Appeals and the One Case Cited by the Circuit Court of Appeals Does Not Support Its Conclusion.

(For the sake of brevity we shall attempt to merely summarize our objections to all the authorities used by the respondent in arguing the case before the Circuit Court of Appeals and the sole case cited by the Circuit Court of Appeals in its opinion.)

(a) The one case cited by the Circuit Court of Appeals, in its entire opinion, *City of New York v. Hall* (C. C. A. 2d 1944), 139 F. (2d) 935, does not sustain the opinion of the Circuit Court and is actually authority in direct support of the position now being urged by your petitioner. [See Appendix p. 34.] The Ninth Circuit points out that "possession" as used in Section 67(c) means actual possession, and states that the purpose of such possession is to protect and give warning to creditors. This reasoning is apropos only as to matters occurring prior to the commencement of the bankruptcy proceedings. For, once the bankruptcy proceedings are commenced, creditors cannot change such rights as existed at the time that the petition was filed. Therefore, simple logic indicates that the possession required in order to warn creditors need not continue once the bankruptcy has commenced—*custodio legis intervenes*. The *Hall* case emphasizes the apparent failure of the Ninth Circuit to properly analyze the facts before it in the instant case. In the *Hall* case the City of New York issued its warrant and docketed claims for city taxes at 1:45 p. m.; at 4:22 p. m. of the same day an involuntary petition in bankruptcy was filed, and not until

4:30 p. m. were the physical assets seized by the city of New York. Therefore, when the receiver sold the property, since the city did not have possession at the time that the bankruptcy commenced, Section 67(c) required a ruling contrary to the claims of lien by the city. In the language of the case itself, page 936, we urge the inapplicability of the *Hall* case to sustain the opinion of the Circuit Court of Appeals:

> "... *for obviously there was not actual possession by the City at the time of the filing of the bankruptcy proceeding.*" (Italics ours.)

That the contention of your petitioner is correct is demonstrated by a reading of the case of *Davis v. City of New York* (C. C. A. 2d 1941), 119 F. (2d) 559, wherein the same tax claimant was upheld for a similar tax where possession was obtained by physical seizure of the personal property on May 16, 1939, and the involuntary bankruptcy was not filed until June 7, 1939.

(b) Not one of the cases cited by the Division of Labor as authorities in support of its argument before the Circuit Court of Appeals, sustains the opinion of the Circuit Court of Appeals any more than does the case of the *City of New York v. Hall, supra,* relied upon by the said Circuit Court. For the sake of convenience, we shall consider all of these cases in the order in which they are presented in the opening and reply brief of the Division of Labor before the Circuit Court.

At page 12 of the opening brief, the Division of Labor cites *In re Auto Repair and Parts Co.*, 41 F. Supp. 3, and *In re Pennsylvania Central Brewing Co.*, 114 F. (2d) 1010. However, the inapplicability of these cases is ad-

mitted by the appellant, at page 12 of its brief, in the following language:

> "The question of possession was not, however, involved in the above cases."

If the case does not involve the issue of possession, we cannot see how it can possibly be used as authority in the instant case on review.

On page 13, *Stratton v. New* (1931), 283 U. S. 318, is cited in support of the contention that the trustee could have appeared in the tax sale proceeding and seized for the bankruptcy estate any balance that might be remaining if the Collector had retained possession of the physical assets involved and had sold the same under his claim of lien. Neither the law nor good business administration requires the following of this practice, and the mere conferring of jurisdiction on the bankruptcy court by stipulating to a transfer of custody without a waiver of lien rights does not defeat priorities in existence at the time of the commencement of the bankruptcy proceedings.[4]

At page 14 of the opening brief of the Division of Labor, the case of *In re San Joaquin Valley and Packing Co.*, 295 Fed. 311, is cited to support a statement of law with which we have no quarrel, and that is that the

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[4]In the matter of *In re Knox-Powell-Stockton Co., Inc.* (C. C. A. 9, 1939), 100 F. (2d) 979, even the Ninth Circuit Court of Appeals recognizes the alternative procedure which we argue is open to creditors and receivers and trustees, in the following language, page 932:

> "This section makes it clear that adjudication in bankruptcy does not interfere with existing valid liens, and that the trustee takes the property of the bankrupt subject to all such liens as would have been enforceable against it in the hands of the bankrupt himself. *Riscook v. Varick Bank*, 206 U. S. 28. . . ."

trustee in bankruptcy is not an agent for the Collector of Internal Revenue, but, as an officer of the Court, represents all creditors. This is undisputed, and, as an officer of the Court, the trustee is required to urge the correct application of the law to the facts, as far as a proper distribution of the assets is concerned, even in the case of one creditor against another.[5]

Also at page 14, the *City of New York v. Hall, supra,* is cited and we believe that we have considered this case sufficiently in subdivision "a" of this portion of the argument. Obviously, the issue of constructive possession is not involved in the instant case for the reason it is stipulated that the Collector had actual possession when the bankruptcy proceedings commenced.

On pages 14 and 15 of the opening brief of the Division of Labor there is cited the case of *In re Jay & Dee Storage Co.*, 37 Fed. Supp. 989. This case does not assist in supporting the opinion of the Circuit Court of Appeals because it does not involve any facts concerning the issue of possession; likewise, it is an opinion involving a claim for rent, rather than taxes, and such a claim is

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[5]"A trustee in bankruptcy is the representative of the creditors."
2 Collier's on Bankruptcy (14th Ed.) 1737;
Eyster v. Gaff, 91 U. S. 521.

The following quotation is from the case of *Atkins v. Wilcox* (C. C. A. 5), 5 A. B. R. 313, 316, 105 Fed. 595:

> "By the clearest implication he (the trustee) represents all the creditors, and as such representative has an interest in the just administration of the estate which belongs to the creditors."

treated differently than a statutory lien for taxes accompanied by actual possession. (See 67(c) of the Bankruptcy Act.)

We have no quarrel with the law stated on page 15 of the opening brief, in the case of *In re Jackson Brick & Tile Co.*, 189 Fed. 686, to the effect that the referee has jurisdiction to determine the validity of a lien.

At page 15, and for several pages thereafter, in the opening brief, the Division of Labor places great reliance upon the case of *In re Lebed*, 39 Fed. Supp. 457. There is no similarity between the facts in the *Lebed* case and the instant case. In the *Lebed* case a landlord's lien for rent is the issue involved, and under Section 67(c) such a lien cannot have priority over the labor claimants even if accompanied by possession. Secondly, the agreement in question in the instant case was entered into after the commencement of the bankruptcy proceedings, *i. e.* after the lien rights of the Collector were frozen, and was not a prebankruptcy agreement as existed in the *Lebed* case.

The last case cited in the opening brief of the Division of Labor is *Freeman Furniture Factories Company, Inc. v. Bowlds*, 136 F. (2d) 136. We have no quarrel with the law stated in the *Freeman* case to the effect that costs of administration are properly chargeable to a fund arising from the sale by the bankruptcy court of certain assets. We make the same contention in the instant case even in the absence of any stipulation to this effect by the Col-

lector of Internal Revenue.* The *Freeman* case states the law as was ably applied by the Referee, in the instant case, and justifies the payment of administration expenses first, then the allowance of the statutory lien claim as accompanied by actual possession. The *Freeman* case cannot be distorted into a ruling in any way supporting the contention that labor claims, as well as expenses of administration, must be allowed prior to the tax lien claims involved in the instant case.

The only new authorities cited by the Division of Labor in its reply brief are contained on pages 3 and 4 in support of a contention that the Receiver in Bankruptcy could not enter into the agreement with the Collector of Internal Revenue whereby the lien would continue on the assets in the hands of the receiver. The cases cited are *In re Kolin,* 134 Fed. 557, and *In re Cox Baking Co.,* 77 F. (2d) 294. Merely reading the quotation from the opinion given by the brief of the Division of Labor indicates the fact that the cases do not at all sustain the statement of the law for which they are cited, and it is basic Hornbook Law that a receiver is an officer of the Court; as such he can enter into binding agreements whereby liens existing at the time of the commencement in bankruptcy shall follow the proceeds from the sale of the physical assets involved in such lien. (See authorities cited under Argument No. 3, *supra.*) When bankruptcy intervenes the legal effect of possession continues, the claimant has merely surrendered custody to the receiver.

*See telegram to Collector, petition for writ of certiorari, p. 7.

Conclusion.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is not only contrary to the law and to the facts involved, but likewise has hampered, and unless reversed, will continue to hamper the orderly and proper administration of bankruptcy proceedings. This is particularly so because the Collector of Internal Revenue is now placed in the position of attempting to hazard a guess as to whether or not a Court will enforce the broad implications of the opinion of the Circuit Court of Appeals and thereby requires the Collector to hold on to all personal property on which he is claiming a statutory lien by virtue of actual possession, and to refuse to surrender such possession to the more orderly and profitable administration of the Bankruptcy Court.

Wherefore, it is respectfully submitted that this petition for Writ of Certiorari should be granted, and that this Honorable Court review the decision of the United States Circuit Court of Appeals for the Ninth Circuit and reverse it.

Dated: March 1, 1948.

Respectfully submitted,

MARTIN GENDEL,
Counsel for Petitioner.

GENDEL & CHICHESTER,
Of Counsel.

APPENDIX.

Opinion of the United States Circuit Court of Appeals.

In the United States Circuit Court of Appeals for the Ninth Circuit.

Division of Labor Law Enforcement, State of California, statutory assignee, etc., Appellant, vs. George T. Goggin, Trustee in Bankruptcy of the Estate of Kesseo Engineering Corporation, and Harry C. Westover, Collector of Internal Revenue for the Sixth Collection District of California, Appellees. No. 11,669. Dec. 9, 1947.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Before: Mathews, Stephens and Orr, Circuit Judges.

Stephens, Circuit Judge.

The Kesseo Engineering Corporation, a California corporation, brought a voluntary petition in bankruptcy, and orders of adjudication and general reference were made on March 26, 1946. At that time the Collector of Internal Revenue had physical possession of the assets of said bankrupt pursuant to certain tax claims, notices of such liens having been filed. The property was put up for sale, but the sale was never completed because the price obtainable was unsatisfactory. The collector then relinquished the assets to the receiver in bankruptcy under an alleged agreement made by and between an official of the Bureau of Internal Revenue and the said receiver, George T. Goggin, in the following circumstances. The Los Angeles office of the collector was contacted in regard to the assets and their sales value by Goggin. A telegram was thereafter sent by the Bureau to

the Los Angeles office as follows: "Reference to telephone conversation today with Mr. Webb [member of the Los Angeles office of Internal Revenue] relative to Kessco Engineering Corporation, bankrupt; no objection by this office to Collector relinquishing personal property to Trustee for sale. Government's lien to attach to proceeds from sale subject to Trustee's expenses including costs of sale." The information as to these transactions were received, but no formal acceptance or acquiescence by the receiver was ever made. No notice thereof was given to the creditors or other parties in interest, nor was any notice of an intended trustee's sale ever given them. The receiver, with knowledge of the telegram, took physical possession of the assets from the collector and later in the capacity as trustee caused the assets to be sold at public auction. What notice, if any, was given does not appear in the record. Prior wage claimants filed their wage claims against the assets through the Division of Labor Law Enforcement of California. The referee put the government's claim ahead of the wage claims to the same extent as though the lien on the property followed the proceeds of its sale. The district court confirmed, and the labor claimants appeal through the California Division of Labor.

The appellant takes the position that by surrendering possession of the assets to the receiver, the collector lost the superior position which he had theretofore enjoyed. It is contended that the collector, not having enforced his lien by sale, subjected himself and his claim to the provisions of Section 67(c) of the Bankruptcy Act [11 U.S.C.A. § 107c (1946)] when he appeared in the proceedings and voluntarily surrendered possession of personal property to the trustee, and that the alleged

agreement heretofore detailed has no legal binding effect on statutory rights of prior wage claimants. It is also urged that, since the referee directed payment of expenses of administration prior to payment of the collector's lien, Section 67(c) of the Act makes it obligatory to also pay the labor claims before payment of the government's claim.

The referee's order and judgment in the district court upheld the superiority of the lien and approved the action on the agreement.

The appellees, in support of the judgment, urge that the agreement or conditions attached by the government to the release and sale of the personal property protected them against loss of superior position. The determination of this question rests upon the construction of Section 67(c) of the Bankruptcy Act, which provides as follows: "Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by *possession* [emphasis ours] of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment of the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payments to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act." Section 64a of the Act [11 U.S.C.A. § 104a (1946)] provides, respectively, for priority of expenses of administration and for wages of

a restricted amount earned within a given time before bankruptcy proceedings to be paid in advance of payment of dividends to creditors.

At the time the proceedings began, the collector had possession of the assets, but he subsequently relinquished them to the receiver and trustee in the already mentioned circumstances. Did the lien follow and attach to the sale proceeds?

The appellants contend that possession under the statute means *actual* possession prior to and subsequent to the filing of the petition in bankruptcy, whereas appellees contend that actual possession, which was enjoyed at the time the action in bankruptcy was commenced, need not be retained in order to protect priority in payment.

We agree with the Second Circuit in City of New York v. Hall, 139 Fed. (2d) 935, in the holding that "possession" as used in Section 67(c) means actual possession, the purpose being to protect and give warning to creditors. In the instant case the government had actual possession, but it surrendered that possession by virtue of a bargain with the receiver without taking into account the wage and creditor claimants. The Act provides that wage claims come ahead of the government lien in distribution of the proceeds of sale of property not in possession of the government lien holder. The government lien holder must either sell the property under its lien or eventually surrender it into the bankruptcy proceedings. We find no authority whatever for the proposition that the government can turn the property over to the trustee under a consent based upon the receiver's assurance that the lien shall continue upon the property and also upon the money it may bring when sold as a part of the bankruptcy estate. It is our opinion that the wage

claimants had certain statutory rights at the inception of the bankruptcy proceedings, and such rights remained throughout the proceedings, modified by the actual possession of the assets. The fact, as is claimed, that the receiver could make the sale to better advantage, is irrelevant, for the question is one of power and not of business judgment. The statutory requirements may not be disregarded through private agreements which affect others' rights without their consent.

In what circumstances, if at all, statutory lien on personal property as a lien may be transferred to the proceeds of the sale of such property by agreement of all concerned need not be considered. Here we have a definite statutory provision based upon a well-understood reason limiting this lien to the actual possession of the property.

We think no argument is necessary or authorities required to support our conclusion that costs of administration come first in the distribution of proceeds derived from property which has been under the jurisdiction of the bankruptcy court.

The judgment is reversed, and the cause remanded for further proceedings in accordance with the views herein expressed.

(Endorsed): Opinion. Filed Dec. 9, 1947. Paul P. O'Brien, Clerk.